Supreme Court of the United States

OCTOBER TERM, 1923.

No. 352.

THE PEOPLE OF THE STATE OF NEW YORK,
Appellant,

against

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Appellee.

BRIEF FOR APPELLANT

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LIST OF CASES CITED.

II.

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CERTIORARI FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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OF THE UNITED STATES

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Appellant,
against
LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Respondent.

APPELLANT'S BRIEF.

Statement of the Case.

On or about December 22, 1920, a petition in bankruptcy was filed in the United States District Court for the Southern District of New York, against the Ajax Dress Co., Inc., a corporation duly organized and existing under and by virtue of the laws of the State of New York. The said Ajax Dress Co., Inc., was duly adjudicated a bankrupt, and the matter of the bankruptcy proceeding was referred to John J. Townsend, as referee in bankruptcy. The respondent, Louis Jersawit, was duly selected trustee of said bankrupt.

On or about April 3, 1922, the appellant, The People of the State of New York filed with the referee in bankruptcy a claim for franchise taxes,

based on the income of the bankrupt for the calendar year, 1919 at four and one-half per cent, said tax being for the privilege of doing business for the year commencing November 1, 1920 and ending October 31, 1921, as follows:

STATE FRANCHISE TAX.

On Business Corporations under Article 9-A of the Tax Law as amended:

For period ending October 31, 1921:

Tax based on income 4½%	$448.34
Penal Interest, etc.	87.03
Total	$535.37

Section 209 of the Tax Law of the State of New York, under which said tax arose, provides as follows:

> "Sec. 209. Franchise tax on corporations based on net income. For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay in advance for the year beginning November first, next succeeding the first day of July, in each and every year an annual franchise tax, to be computed by the tax commission, upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the

same as the entire net income upon which such corporation is required to pay a tax to the United States."

The rate of the tax is fixed by Section 215 of the Tax Law of the State of New York, providing that the tax shall be at the rate of four and one-half per centum of the entire net income of the corporation or the portion thereof taxable within the state.

Section 219-c of the tax law of the State of New York, provides that the tax shall be paid to the State Tax Commission on or before the first day of January of each year, and that, if the tax be not so paid

> "the corporation liable for such tax shall pay to the State Tax Commission, in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remains unpaid.
>
> Each such tax or additional tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same until the same is paid in full."

At the first meeting of the creditors of the Ajax Dress Co., Inc., bankrupt, held before the Referee at his office on the 12th day of April, 1922, the respondent, Louis Jersawit, as Trustee in Bankruptcy, made objection to the claim of the appellant, The People of the State of New York, as filed, and contended:

1. That there shall be an apportionment of the state franchise tax for the year be-

ginning November 1, 1920, as follows: viz., that the tax claim should be allowed only for that portion of the year which elapsed between the beginning of the tax year, November 1, 1920 and the date of the filing of the petition in bankruptcy, December 22, 1920, and that the entire amount of the tax claim should thus be reduced proportionately as the elapsed period bore to the entire year.

2. That the statutory interest should not be allowed.

The referee held, in disposing of the objections that the tax assessed against the bankrupt, being under statute directed to be paid in advance, based upon income earned in the state during the preceding year was not apportionable and must be paid in full; and that under the law as established *in re.* Kallak, 17 A. B. R., 415, 147 Fed. Rep. 276; *In re.* G. L. Schuyler & Co., 21 A. B. R., 428; *Re.* Scheidt & Brother, 23 A. B. R., 778, 187 Fed. Rep., 599; *Re.* Ramirez-Quinones, 29 A. B. R., 323, U. S. vs. Guest, 143 Fed. Rep., 456, the statutory exaction made by the statute for non-payment of the tax should be construed as prescribing interest and not as imposing a penalty. The referee refused to follow a decision to the contrary rendered *in re.* Ashland. Emery & Corundum Co., 36 A. B. R., 194, 229 Fed. Rep. 829. A referee's order was accordingly entered on November 2, 1922, ordering that the claim of the State of New York filed on the 3rd day of April, 1922, for a franchise tax for the period ending October 31, 1921 be allowed in the sum of

$448.34 for the principal of said tax, and interest upon said principal at the rate of 1% per month from January 1, 1921 to the date of the payment of said tax in addition to the said principal sum, and that the said claim be allowed as one entitled to priority of payment.

Thereafter, the trustee in bankruptcy duly filed a petition to review the said order of the referee and obtained a certificate of the referee on said petition under date of November 23, 1922, certifying the determination made by the referee as stated, and the papers and proceedings upon which the said determination was based. A hearing upon said petition and certificate was duly held by the United States District Court for the Southern District of New York, Justice Augustus N. Hand, United States District Judge, presiding, on the 29th day of November, 1922. United States District Judge, Augustus N. Hand, rendered an opinion, holding that the tax due and owing to the People of the State of New York should be apportioned as prayed for by the trustee in bankruptcy, and, following the decision *in re.* Ashland, Emery & Corundum Co., 36 A. B. R., 194, 229 Fed. Rep. 829 and refusing to follow the other decisions mentioned in the opinions of the referee, and further holding that the interest to be allowed to the appellant, The People of the State of New York, on its tax claim as apportioned, be at the rate of 6% per annum to the date of pay-

ment. An order of the District Court for the Southern District of New York reversing the referee's order in the manner and form stated was duly entered on the 20th day of December, 1922.

The appellant thereupon prosecuted an appeal to the United States Circuit Court of Appeals for the Second Circuit, as well as presenting to said court a petition to revise the said order of the United States District Court for the Southern District of New York on seven assignments of error duly filed which related to the action of the District Court of the United States for the Southern District of New York in apportioning its tax claim as filed in the manner as stated and in reducing the interest rate allowed by the referee to 6% per annum. The said appeal was duly argued in said Circuit Court of Appeals for the Second Circuit during the April term of said court, and on April 23, 1923, a decision was duly entered, affirming the decree of the District Court of the United States for the Southern District of New York.

Thereupon, the appellant, The People of the State of New York, duly filed its petition for a writ of certiorari with this court. The writ of certiorari applied for was granted by this court and the case is now before this court for determination on the merits.

Specifications of Error Relied Upon.

The appellant contends:

1. That the determination made by the United States Circuit Court of Appeals for the Second Circuit is contrary to and subversive of the expressed language of the statute of the State of New York, relating to taxation and the decisions of the courts of the State of New York in the interpretation of such statute.

2. That the decision of the Circuit Court of Appeals for the Second Circuit was based upon a misapprehension of what the courts of the State of New York have decided respecting the questions at issue, and misconstrued the meaning and intent of Section 209 of the Tax Law of the State of New York.

3. That the decision of the Circuit Court of Appeals of the United States for the Second Circuit unjustly operates to take away the effect of the statutes of the State of New York, relating to taxation, erroneously limits the scope of such statutes and seriously affects the taxing power of the State of New York.

4. That the decision of the United States Circuit Court of Appeals for the Second Circuit is erroneous in determining that the franchise tax assessed against the bankrupt herein should be

apportioned, and that the interest on such tax should be limited to the rate of six per cent per annum instead of the rate provided for by statute, and that the law to be now determined in this case is correctly stated in the opinion and order of the referee in bankruptcy of the bankrupt, Ajax Dress Co., Inc.

5. That error was committed in affirming the order of the United States District Court for the Southern District of New York in reversing the order of the referee dated November 2, 1922, and apportioning the tax claim filed by the appellant, The People of the State of New York.

6. That error was committed by the Circuit Court of Appeals for the Second Circuit, in affirming the order of the United States District Court for the Southern District of New York, and in reversing the order of the referee, so far as the said order provided that the tax should be apportioned for the period of the taxable year to the period of the taxable year that elapsed prior to the filing of the petition in bankruptcy.

7. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York, in holding that the franchise tax, claim for which was filed with the referee in bankruptcy was one for the actual exercise of a franchise and not for the privilege of exercising a franchise.

8. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in finding and deciding that this tax should be apportioned notwithstanding the fact that the statute law of the State of New York made the tax payable in advance.

9. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in that said order, and the opinion upon which it was based failed to find that the tax, claim for which was filed, was based upon income for the calendar year 1919, as shown in the return made by the Ajax Dress Co., Inc., to the United States Internal Revenue and was at the rate of four and one-half per cent thereof and was audited and stated by the State Tax Department of the State of New York for the privilege of doing business for the year commencing November 1, 1920, and ending October 31st, 1921, and was payable in advance by the terms of the New York statute.

10. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in that said order failed to recognize the lien created by the statute law of the State of New York for said taxes from

the time that same was payable until it was paid in full.

11. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in reducing interest upon the said claim from one per cent a month to six per cent per annum, notwithstanding the fact that the statute law of the State of New York provides for interest at the rate of one per cent per month.

POINT I.

The Franchise Tax assessed against the Ajax Dress Co., Inc., pursuant to Section 209 of the Tax Law of the State of New York, being payable in advance November 1, 1920, based upon the income that the corporation earned for the preceding calendar year was one for the privilege of continuing to exercise the corporate franchise and should not be apportioned in amount to the period prior to December 22, 1920, when said corporation was adjudicated a bankrupt.

The protection which should be accorded to the state in the conservation of its taxing powers has been already announced by this court. In Marshall vs. The People, 254 U. S., 380, this court permitted a certiorari to issue to the United States

Circuit Court of Appeals for the Second Circuit, so that the matter of state priority in the collection of tax obligations could be finally determined, and this court in holding, in this decision, that the state is entitled to be paid the amount of tax obligations due it as a priority creditor because of its sovereign capacity, has fully recognized the principle that is of vital importance to the stability of government, that the state be protected to the utmost in securing that revenue upon which the ability to govern depends. This same principle is controlling in the decision of this court in the case of New Jersey vs. Anderson, 203 U. S., 483, construing the tax statute of the State of New Jersey. This court held in said authority that the state creating a corporation may fix the terms of its existence, and provide that for the continued exercise of its franchise it must yearly pay the state certain sums fixed by the amount of its outstanding stock. In that case, the franchise tax due by the corporation was payable on January 1st of each year for the ensuing year. The corporation was adjudicated a bankrupt on April 23, 1903, a little over four months after the tax was payable. This court held that the tax must be paid in full, even though no specific lien against the property of the corporation attached when the corporation went into bankruptcy. Mr. Justice Day of this court stated, page 494:

> "The amount claimed for the year 1903, it is insisted had not accrued at the time the adjudication in bankruptcy, which was on April 23, 1903, the return being made on

May 2, 1903 and the assessment was not made until July 1, 1903; but the actual return required to be made to the board on or before the first Tuesday in May is upon the basis of the capital stock issued and outstanding, as of January, preceding the making of the return. The Bankruptcy Act requires the payment of all tax legally due and owing. We think the tax thus assessed upon that basis was legally due and owing, although not collectable until after the adjudication."

The New York statute is similar to that of the New Jersey statute as to the specific income of the corporation upon which the return to the state is to be measured. The franchise tax levied by the State of New York is based upon a percentage of the income earned in the state for a preceding year to November 1st of each year. The New York statute prescribes clearly that the tax thus assessed upon that basis legally due and owing on November 1st, and grace is given to the corporation affected to pay the tax without penalty on or before January 1st succeeding. There is nothing in the statute relative to any apportionment of the tax thus levied, and the plain reading in the language of the statute negatives any possibility of any such construction thereof.

The Circuit Court of Appeals for the Second Circuit, on this question, relied upon the case of People vs. Mutual Trust Co., 177 N. Y. 51, which construed present Section 188 of the tax law of the State of New York relating to franchise tax on trust companies, and which provides that

"Every Trust Company incorporated, organized or formed under, by or pursuant to a law of this state * * * shall pay to the State annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity, an annual tax which shall be equal to one per centum on the amount of its capital stock, surplus, and undivided profits."

By relying upon this early Mutual Trust Company case the Circuit Court of Appeals has misunderstood the present state of law in New York. The New York Court of Appeals has directly shown the inapplicability of the Mutual Trust Company case to the present system of taxation, and it has done so by a full discussion of the Mutual Trust Company case. We are referring to the later decision in People *ex rel.* N. Y. C. & H. R. R. R. Co. vs. Gaus, 200 N. Y. 328, a decision not commented upon by the Circuit Court of Appeals or by Judge Hand. In the New York Central case the tax was payable in advance, while in the Mutual Trust Company case the tax was payable for the past year. Speaking of its determination in the first case and showing the difference between the two taxes the Court said, at page 330:

> "this court held in *People ex rel. Mutual Trust Co. v. Miller* (177 N. Y. 51), where the relator began business a few days before the end of the tax year, that it was only the average outstanding stock during the year which was to be taken as the basis of the tax. In that case we treated the franchise tax as an

exaction *for the privilege afforded to the corporation for the past year. After our decision, however, the legislature amended section 182 of the Tax Law so as to provide that the tax should be paid in advance. The amendment changed the character of the tax as to corporations embraced within that section, from a payment for past privileges already enjoyed to a payment for privilege to be enjoyed in the following year.* Trust Companies are not taxed under section 182, but under section 187a. While the tax in each case is a franchise tax and so regarded in law, there is a very marked distinction between the two. The tax imposed on corporations generally under section 182 amounts to 1½ mills on the capital stock of a corporation paying 6% dividends, and its payment does not exempt the corporation from local or property taxes. On the other hand, the tax on a trust company is 1%, and relieves the company from all other taxation. *After the amendment of section 182, the grounds on which we placed our decision in the Mutual Trust Co. case became no longer applicable to corporations taxed under that section.* But that amendment in no way affected corporations taxed under section 187a, where a very different tax is imposed. For this reason our decision in the Mutual Trust Co. case, so far as it related to trust companies, remained unaffected. Subsequently there arose the case of People *ex rel.* Lincoln Trust Co. v. Glynn (132 App. Div. 546), the decision in which was affirmed by this court on the opinion below in 198 N. Y. 501. In that case it was held that the method of taxation of trust companies had not been altered by the change in the law. *The distinction between the two cases was clearly pointed out* in the opinion of the learned Appellate Division."

All of the foregoing was unnoticed by the Circuit Court and by Judge Hand, and it is doubtful whether the lower courts appreciated the existence of the opinion in the New York Central case.

The District Court refers also in its opinion to People *ex rel.* Lehigh and New York Railroad Co. vs. Sohmer, 217 N. Y. 443, where Section 182 of the Tax Law as it then read was under review. Section 182 of the Tax Law considered by the court in said case, reads radically different from Section 209 of the Tax Law in the instant case, in that the words in section 182 "for the privilege of doing business or exercising its corporate franchise in this State" were at the time the Lehigh case was before the courts qualified by the repetition of the words "doing business in this State." In other words, both a domestic corporation as well as a foreign corporation had at that time *to be doing business* before a tax accrued. After the decision in 217 N. Y. 443, and because of it the legislature amended Section 182 of the tax law, eliminating the words "doing business" when applicable to domestic corporations. The legislature has therefore given clear expression of its intent, that it changed the ruling as made by the Court of Appeals in 217 N. Y. 443, and that the doing of business in the case of a domestic corporation was not to be considered as affecting the tax accruing under section 182 of the tax law. In like manner, the legislature has provided, in Section 209 of the tax law, that the doing of business in this state had no relation

to domestic corporations such as the bankrupt herein or as to its privilege of exercising its franchise in this State in a corporate or organized capacity. The reason for the tax and the actual privilege taxed are stated differently for a domestic corporation and for a foreign corporation, the tax for a domestic corporation is for the privilege of "exercising its franchise in this state in a corporate or organized capacity," and the tax for a foreign corporation is for the privilege of "doing business in this state":

> "Sec. 209. *Franchise tax on corporations based on net income.* For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section shall annually pay in advance for the year beginning November first next succeeding the first day of July in each and every year an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as herein after provided, which entire net income is presumably the same as the entire net income upon which such corporation is required to pay a tax to the United States, * * *."

The tax is directed to be paid on the basis of income earned during the preceding year and was expressly directed to be paid in advance of the ensuing calendar year. Neither the basis upon which the tax was calculated nor the time of payment has any reference to business to be trans

acted thereafter. It is akin to a license fee or income tax based upon benefits theretofore derived in the State as a condition for permission to continue to exercise such privilege or franchise for a succeeding year. It was a measure of valuation adopted by the legislature so that the franchise could be uninterruptedly exercised and its value at all times definitely determined (People *ex rel.* Barcalo Mfg. Co. vs. Knapp, 227 N. Y. 64).

This question was construed in New York Terminal Co. vs. Gaus, 204 N. Y., 512, where property of a corporation was operated by a receiver during which period of operation franchise taxes for the privilege of doing business or exercising corporate franchises were levied by the State. The property of the corporation was sold by the receiver during the tax period under foreclosure. It was held that the lien of the tax continued in its entirety.

Likewise in the case of Marshall, 254 U. S., 380, there was no suggestion of an apportionment. In that case the District Court allowed the full amount of the franchise tax without apportionment.

The case of New York Terminal Co. vs. Gaus was followed by this Court in Penn. Steel Co. vs. The New York City Railway Co., 198 Fed. Rep., 768. Judge Ward, page 771, stated:

> "These taxes were made a lien by Section 197 of the Tax Law, and although we have

> held under the similar Federal Law, (Chapter 6, Laws of 1909), that they are not payable by receivers, the Court of Appeals of the State of New York has held that a similar tax under Section 182 of the New York Tax Law is payable by the receivers and remains a lien on the premises after sale and foreclosure, New York Terminal Co. vs. Gaus, 204 N. Y., 512. We feel obliged to follow this decision and to hold that the purchaser take the premises subject to the tax."

The real purpose of the franchise tax enacted by Section 209 of the Tax Law further appears from the decision in People *ex rel.* Cornell Steamboat Company vs. Sohmer, 206 N. Y., 651, in which case Cullen, J., stated:

> "I doubt whether in the true sense of the term it is to be considered a tax, but should not rather be deemed a compensation, exacted for the privilege which the State might refuse. If the parties beneficially interested in the appellant are dissatisfied with the price exacted by the State they may have the corporation dissolved and as individuals carry on the same business that is being done now without the cost of any such charge."

The laws of the various states, particularly that of the State of New York, furnish innumerable instances where a particular trade or calling or the performance of particular acts, is required to be licensed, and where one of the conditions of obtaining such license is the payment of a fee covering a particular license period. Various illustrations are found under the general business laws of the State of New York, relating to the

licensing of auctioneers, peddlers, junk-dealers, private detectives, warehousemen, employment agencies and moving picture exhibitions; under the general Highway Law, relating to the registration and licensing of motor vehicles; under the Charter of the City of New York, creating the license bureau of the City of New York, which has jurisdiction over various other forms of business activities. It is academic that where a license is granted upon payment of the legal fee covering a stated period that no refund of such license is permissible, even though the licensee does not avail himself of the privilege conferred for the entire license period.

(Hart vs. Beauregard, 22 L. A. Ann., 80.)

Other instances of non-apportionment of a debt payable in advance for a certain privilege conferred, is afforded by leases, which provide that rent for certain periods should be paid in advance. It has been determined by this court and other Federal courts, in bankruptcy that where such is the case the claim of the landlord can be proven for the amount of the stipulated rental payable in advance, even though the tenure of the term covered by said rent should have been interrupted by bankruptcy proceedings (*Re* Pittsburgh Drug Co., 164 Fed. Rep., 162; McCann vs. Evans, 185 Fed. Rep., 93; *Re* Sherwoods, 210 Fed. Rep., 754; *Re* Scruggs, 205 Fed. Rep. 673).

The tax due to the State of New York was due November 1, 1920. The payment thereof, made it

lawful for the corporation to continue to exercise its franchise for the ensuing year. It recognized the liability for the tax by taking advantage of the privilege conferred by the State in continuing to exercise its franchise after the tax had accrued. The State is not interested to what extent the privilege conferred is exercised. Any act done by the corporation under the privilege conferred makes it amenable to respond to a tax of this nature which, by statute, is expressly stated to be paid in advance. There is nothing in the statute relative to any apportionment of the tax thus levied. In the absence of any statutory direction, no apportionment can be decreed by the Court.

The inequitableness of apportioning or prorating a tax is pointed out in the case of Archibald McNeil & Sons Co. *et al.*, vs. Bay State St. Ry. Co., 282 Fed. 338. In that case the tax was based on the gross earnings for a complete year and the court says:

> "By the statute the computation of the tax is based on the return of the street railway company. In certain details, which might change from month to month, it has been definitely held by the Supreme Judicial Court that there could be no prorating or adjusting; that the intent of the statute was that the assessment should be based on the facts as they exist on September 30. See N. & C. Street Railway vs. Wellesley, 207 Mass. 514. 93 N. E. 834. There is no provision in the statute for prorating the tax between different operating companies when there has

> been a change of ownership during the tax year; nor is there any requirement that a company not operating on September 30th shall file a return. The tax is based on gross earnings for a complete year. It disregards operating expense. During the winter months, operating expenses are apt to be much heavier than during the summer. Taxing the gross receipts of the company (or person) which operated during the winter the same as the one operating only during the summer might be unjust to the former."

The reasoning of the Court in the above case applies as well to the instant case where the tax is based on net income as where it is based on gross earnings. The net income of corporations vary materially each month, depend to some extent on the character of the business conducted. Some corporations have little net income during the winter months; others enjoy their greatest return at that season of the year. Some have their greatest prosperity in the summer months, while others do not.

It is plain therefore, that to adopt a straight line method of apportionment irrespective of the net income of the corporation during the months apportioned, would ofttimes be unjust and inequitable and furthermore contrary to the intention of the legislature.

The foregoing question together with that discussed under Point II, of this brief arises in every bankruptcy proceeding in which a corporation is

a bankrupt. In every such instance, bankruptcy is bound to occur during some part of the year for which a franchise tax making it legal to continue to exercise the franchise, is payable. In every such bankruptcy proceeding, a similar claim for apportionment has been and will be made. Such construction resulting in a large depreciation of the amount of taxes which the State received was clearly not within the contemplation of the legislature of the State of New York on its enactment of the statute. It was to avoid such a consequence that the legislature has directly stated that the tax should be paid in advance, and based, not upon business to be done in the future, but on the value of the franchise as determined by the income of the corporation earned during the preceding year. The tax is directly stated to be for the purpose of exercising the corporate franchise within the State of New York, and the continued receipt of the benefits, which the corporate laws of the said State have theretofore conferred upon the corporation.

A statute must be construed with reference to the object to be accomplished by it. In order to attain this object, it is proper to consider the occasion and the necessity of its enactment, the defects or the faults in the former law and the remedy provided by the new law; and the statute should be given that construction, which is best calculated to advance its object by suppressing the mischief and securing the benefits intended, hav-

ing regard to the considerations of public policy and to the established policy of the legislature as indicated by a general course of legislation.

Adopting this well recognized canon of statutory construction, the legislature of the State of New York in the enactment of present Section 209 of the Tax Law of the State of New York plainly intended to eliminate any doubt as to the meaning of language employed in the amendment of that previously contained in tax statutes. This is clearly indicated in the opinion People *ex rel* New York Central & H. R. R. Co. vs. Gaus, an extract of which has heretofore been printed in this brief. Under these circumstances, the referee was clearly right when he stated in his opinion that

> "The tax imposed under either Section 209 or Section 182 as amended is a payment for a privilege whether exercised or not, and is due annually from the corporation until its franchises are withdrawn by the legal dissolution of the corporation, provided always that such tax or payment has been computed or ascertained in the manner required by Section 209 and Section 182 as amended."

POINT II.

The statutory rate of interest provided for by the Tax Law of the State of New York at the rate of one per cent per month should prevail.

The Circuit Court of Appeals for the Second Circuit has further determined that the statutory

rate for delinquency of payment of the tax was a penalty and should be disallowed, and that only 6% interest per annum should be allowed upon the taxes apportioned to the day of the date of actual payment by the Trustee, following a decision it made contemporaneously with the decision of the Ajax Dress Co., involving construction of a Federal statute, conferring similar statutory interest upon tax due the United States Government. *Re:* Menist—In the Menist case, the court refused to follow the decision *in re.* Kallak, 147 Fed. 276; Scheidt 177, Fed. 599; *Re:* Quirnes, 39 A. B. R., 320; and followed in *Re:* Ashland, 229 Fed. 829.

From the opinion, it clearly appears that the question under consideration is one upon the true determination of which various circuits have differed. The decision rendered by the Circuit Court of Appeals for the Second Circuit is contrary to the true principle to be applied for the determination of this question.

In the case of People vs. The Gold & Stock Telegraph Company, 98 N. Y., 67, it was held that it was error, on non-payment of a franchise tax due to the State of New York to allow interest on the tax at six per cent per annum, the Court holding that the statute prescribed the exaction for default in payment and no other additional amount could be collected. The court per Danforth, J., stated, page 79:

> "The State at its pleasure created the charge or tax, and prescribed the penalty for

default of payment. No other can be collected. In this case the Comptroller is directed to add 'ten percentum to the tax of said corporation or company * * * for each and every year for which such tax shall not have been paid' (Sec. 2) and by Section nine an action is given to the People for tax imposed. Interest is not given either by this act or by any general law of the State. The payment of which cannot be imposed by implication. What the State omitted to demand, the Court cannot require. But the legislature has not overlooked in this respect any property right of the State. Where interest is given, it is as damages or compensation for delay in payment. The creditor is supposed to have lost something and to acquire indemnity. Here the legislature has ordained it. Ten per cent annually is to be added. Whether it lay in the mind of the legislature that this was interest or not, we do not know. It is what is given; and that it is given and nothing more, excludes any plausible contention that the taxpayer is liable beyond it."

That no interest other than as prescribed by the Legislature is collectible by the State upon delinquency in the payment of taxes was also determined in City of Rochester vs. Bloss, 185 N. Y. 42. As the court in said decision clearly indicated, (page 52), taxes being mere statutory impositions do not bear interest at common law, nor do statutes providing for interest on debts, contracts and judgments apply to taxes. They do not draw interest as do sums of money owned upon contract but only if it is expressly given. The amount to be paid for the delinquency of a taxpayer to compensate the State for losses sus-

tained through such delinquency must therefore be prescribed by the Legislature.

This statutory charge akin to that interest charge is prescribed in respect to the taxes, allowed in this case by Section 219c of the Tax Law, which prescribes the rate of one per cent per month in addition to ten per cent of the amount of the tax.

In United States vs. Guest, 143 Fed., Rep. 456, the Circuit Court of Appeals for the Fourth Circuit held that the provisions of the United States statutes providing for the collection of delinquent internal revenue taxes with the penalty of five per cent per month, thereon and interest at the rate of five per cent per month, that such interest was not a penalty but was recoverable as interest, there being a five per cent penalty specifically prescribed on the amount of the tax.

In the case of Marshall vs. The People, 254 U. S., 380, The United States Supreme Court affirmed the right of the State to recover in full the amount of taxes due from a corporation in bankruptcy, which embraced within the claim all that the Legislature of the State prescribed should be a part of the tax obligation. This sovereign prerogative to receive in full the moneys required for the public revenue has been at all times recognized in the administration of the Bankruptcy Law of the United States. In fact, Section 64a of the Bankruptcy Act in express words

directs taxes due to a State to be paid in advance of the payment of dividends to creditors without reference as to whether such taxes are liens upon the property of the bankrupt. Bankruptcy cannot therefore operate to divest the State of a right which it could have enforced through its revenue officers by the superior power of distress but for the fact that the property assets of its debtor had passed into custody of a court whose duty it was in the administration and distribution of those assets to respect that paramount right upon the untrammelled exercise of which depends the power to protect the very fund being distributed. (American Bonding Company vs. Reynolds, 203 Fed. Rep., 356; Pennsylvania Steel Co. vs. New York City Railways Co., 193 Fed. Rep. 721; Greeley vs. Provident Savings Bank, 98 Mo., 458).

It is in the application of this principle that the courts in the decisions *in re* Kallak 147 Fed. Rep., 276; *In re* G. L. Schuyler & Company, 21 A. B. R., 428; *In re* Scheidt & Brothers, 23 A. B. R. 778, and *In re* Ramirez-Quinones, 39 A. B. R, 320, determined that the statutory execution for delinquency in payment of a tax due to the State became a part of the tax itself and was recoverable in connection therewith.

In re Kallak, *supra*, Amidon, District Judge, stated page 278:

> "So strongly have these considerations appealed to the courts, that the estates of bankrupts, even while in *custodia legis*, have been

> held subject to taxation by the State and its subordinate agencies."

It was held that if estates may be taxed under such circumstances, no sound reason can be advanced why revenue laws fixing the penalties with full effect in the case of taxes legally levied and assessed prior to the adjudication.

So also *In re* Scheidt & Brothers, *supra*, Sater, District Judge, gives a sound and logical reason for the principle as follows:

> "Its allowance is intended to cover interest until the delinquent taxes are put into judgment (Wheeling & Lake Erie R. R. vs. Wolfe, 13 Ohio Cir. Court Rep., 374), or are paid voluntarily or are collected by special effort by the treasurer in person or by his agent—in some manner other than by process of law. The penalty being treated as interest is collectible as part of the tax itself. (27 Amer. & English Encyc, of Law, 777, 778, 779). Under Section 64 of the Bankruptcy Act, the referee should have directed payment of both the taxes and penalty."

The decision in Ashland, Emory & Corundum, 229 Fed. Rep., 829, which the Circuit Court of Appeals followed, is not alone opposed to the weight of authority but unsound in principle. In allowing the interest at the rate of six percent per annum the Court disregards the well established common law principle that tax obligations bear no interest unless prescribed by the Legislature. In treating the penalty for non-payment of the tax in the same manner as a penalty incurred for the vio-

lation of a criminal statute the Court disregards the well established principle that the Legislature has the right to prescribe an exaction for non-payment of a tax which exaction, unlike the penalty for the commission of a crime, becomes a part of the tax obligation itself similar to ordinary interest on a debt.

The instant case furnishes the additional reason that under the decisions of the Courts of the State of New York, to which reference has been made in this brief, the Courts of the claimant State have determined that the penalty or exaction in question was a legislative imposition of interest, which it was justified to pass as such and which when accrued, became part of the tax obligation and was collectible through the same procedure as the tax itself. The statutory interest, as did the tax, became a lien upon the real and personal property of the debtor. This lien must be recognized by this court to the same extent as the original tax lien. Through the Circuit Court of Appeals, Second Circuit, following the decision quoted, a precedent has been created in this Circuit contrary to principle and authority, and one calling for a final review by this court.

Not alone is the State of New York vitally interested in the proper determination of the question involved, also the National Government in a similar construction of the Federal statute as considered in Matter of Menist, *supra*. In like manner as the first question involved in the instant case, the question of interest is one that will arise

in all bankruptcy proceedings in which the bankrupt is a corporation, and it is as equally necessary to have this question finally and correctly determined.

CONCLUSION.

The decision and determination of the United States Circuit Court of Appeals for the Second Circuit should be reversed and the cause remanded to the said court for the entry of a decree in accordance with the opinion of this court, holding that the claim of the State of New York as filed with the referee in bankruptcy of the Ajax Dress Co. Inc., should be allowed in full without apportionment, and paid in the amount as filed together with interest at the rate of one per cent per month from November 1, 1920, together with the costs and disbursements of this appeal.

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